

## SPOTLIGHT ON

### The Publisher Exclusion from the “Investment Adviser” Definition

*The contents of this Spotlight have been prepared for informational purposes only and should not be construed as legal or compliance advice.*

#### OVERVIEW

Financial professionals with a sizable subscription to their blogs or online newsletters often wonder if they are subject to registration as an investment advisor. Given the broad reach of the internet, they might even fall under the jurisdiction of the Securities and Exchange Commission (“SEC”).

Section 202(a)(11) of the Investment Advisers Act (“Advisers Act”) generally defines an “investment adviser” as any person or firm that: (1) for compensation; (2) is engaged in the business of; (3) providing advice, making recommendations, **issuing reports, or furnishing analyses on securities, either directly or through publications**.

Generally speaking, every person or entity providing investment advice for compensation potentially falls within the definition of an investment advisor, except for eight specified categories of persons set forth in Section 202(a)(11). We discuss one of those eight categories, the “Publisher Exclusion,” in this Spotlight.

Section 202(a)(11)(D) of the Advisers Act states that “the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation” is not an investment advisor. Although the Advisers Act does not address the scope of this exclusion, we base this discussion on the seminal United States Supreme Court case *Lowe v. SEC*<sup>1</sup>. In order to rely on the “Publisher Exclusion,” the publisher must meet each of the following criteria:

- Bona fide or genuine;
- Disinterested or impersonal advice; and
- General and regular circulation.

We explain each of these three criteria in more detail below.

#### What constitutes a bona fide or genuine publication?

For purpose of this exclusion, bona fide or genuine publications should contain disinterested commentary and analysis as opposed to marketing materials or personal communications in the guise of newsletters or financial blogs. The publications should not serve primarily as a “vehicle

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<sup>1</sup> *Lowe v. Securities and Exchange Commission*, 105 S. Ct. 255 (1985).

for distributing investment advice<sup>2</sup>.” Lastly, they should not contain any false or misleading information. The publications, however, may contain advice or comments about specific securities so long as they do not have personalized character that identifies a statutory investment advisor.

What is disinterested or impersonal advice?

In connection with the bona fide requirement, disinterested or impersonal advice could prevent the publisher from developing into a fiduciary, face-to-face relationship with the readers that is characteristic of a traditional investment advisory relationship. Therefore, the publication should avoid providing individualized advice attuned to any specific portfolio or satisfying any reader’s particular needs<sup>3</sup>. Additionally, the publisher should not possess any kind of authority over the readers’ funds or securities or manage the readers’ portfolios or account; the publisher should also avoid customized and investment-related interactions with readers.<sup>4</sup>

What is general and regular circulation?

The circulation should be available to the public either for a fee or no charge in a free, open market. The publications need not be published on a consistent basis, such as monthly, quarterly, or semiannually. However, they should be regular “in the sense of important to the securities market”<sup>5</sup>; the publications should not be periodic tips or bulletins on the advisability of the sale or purchase of specific securities, typically in response to market events.

## SPECIFIC SCENARIOS

We explain how to apply the “Publisher Exclusion” in a series of specific factual scenarios, adapted from relevant case law and SEC no-action letters.

### Scenario I: *Lowe Management Corp’s Newsletter*<sup>6</sup>

Christopher Lowe publishes *The Lowe Investment and Financial Letter* through his corporation Lowe Management Corp. It is advertised as a semi-monthly market newsletter. A typical issue contains general observations on an assessment of the securities and bullion markets, a review of numerous market indicators, market strategies, and specific recommendations for buying, selling, or holding stocks and bullion. A year’s subscription costs \$195, but a promotional subscription is offered from \$39 for one year to \$79 for three years. The newsletter has approximately 2,408 subscribers whose subscriptions vary in length from three months to three

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<sup>2</sup> *Id.* at 207 citing *SEC v. Wall Street transcript Corp.*, 422 F. 2d 1371, at 1378,

<sup>3</sup> *Id.* at 208.

<sup>4</sup> See *In re Weiss Research, Inc.* Investment Advisers Act Release No. 2525 ( June 22, 2006) available at <https://www.sec.gov/litigation/admin/2006/ia-2525.pdf>

<sup>5</sup> *Lowe v. Securities and Exchange Commission*, 105 S. Ct. 255 (1985) at 209.

<sup>6</sup> *Id.*; *SEC v. Lowe*, 752 F. 2d 892 (1984).

years. Despite the advertising, only eight issues have been published. The newsletter also advertises a telephone hotline through which subscribers can call to get current information on the assets. Christopher does not own the investments the newsletters recommend, nor is he compensated for promoting or recommending any investments.

## Analysis

### **Christopher Lowe/Lowe Management Corp qualifies for the Publisher Exclusion.**

First, the newsletter contains general observations on the markets and a review of numerous market indicators, market strategies, and specific recommendations. In other words, the newsletters do not provide personalized advice attuned to a subscriber's specific portfolio or investment objectives. The mere fact that the newsletters contain recommendations about specific securities does not make them personalized advice. Moreover, Christopher is completely disinterested in the investments, as he does not own the securities the newsletters. Therefore, the newsletters are disinterested and impersonal.

Second, Christopher is not compensated for promoting or recommending any investments, and the newsletters do not have any false or misleading information. Therefore, the newsletters are a bona fide or genuine publication, as opposed to marketing material disseminated by a tout.

Last, the newsletters are advertised and sold in an open market and available to anyone who is willing to subscribe. The newsletters do not offer more information to subscribers of a longer-term than those of a shorter term. Although the newsletters have not been published semi-monthly as advertised, they are considered regular in the sense of being important to the markets, because the newsletters are not "hit and run tipsters" who from time to time, only react to specific market events. Therefore, the newsletters are of general and regular circulation.

### Scenario II: *Weiss Research*<sup>7</sup>

Weiss Research offers ten different premium services newsletters, each of which presents a different investment strategy, varying from stock investments to options trading. Weiss Research helps potential subscribers choose the premium service that is best for them by evaluating their risk profiles through an online questionnaire. In addition to periodic analysis of market conditions and business developments, subscribers receive frequent emails that often only identify the investment and provide verbatim trading language for the subscribers to recite to their brokers. These trading instructions are sent only when Weiss Research purports to see an investment opportunity arise. Weiss Research also employs customer service representatives available to

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<sup>7</sup> See *In re Weiss Research, Inc.*, Investment Advisers Act Release No. 2525 (June 22, 2006) available at <https://www.sec.gov/litigation/admin/2006/ia-2525.pdf>

answer questions regarding premium services. Weiss Research charges its subscribers between \$100 and \$5,000 for annual subscriptions and has a total of approximately 10,000 subscribers.

Weiss Research enables its premium services subscribers to engage in “auto-trading” arrangements in which subscribers request that Weiss Research send trading instructions directly to their broker-dealers—from a list of brokerage firms provided by Weiss Research—for automatic execution. Weiss Research receives no commissions or fees from the auto-trading broker-dealers or additional fees from auto-trading subscribers. Approximately 25% of its premium services subscribers utilize auto-trading. Weiss Research requests and receives from some auto-trading broker-dealers copies of trade confirmations for purposes of record keeping and customer service.

Weiss Research advertises that its auto-trading arrangements compliments Weiss Research’s premium services and eliminates the need for subscribers to manually review and communicate orders to their broker-dealers. However, these advertisements selectively highlight profitable trades, omit specific references to unprofitable trades, and present an unrealistic picture of Weiss Research’s investment success. For example, one advertisement claims that the subscribers who followed Weiss Research’s recommendations reaped 400% profits. In reality, Weiss Research’s premium services newsletters have not been profitable for subscribers.

## Analysis

### **Weiss Research does not qualify for the Publisher Exclusion.**

The most outstanding disqualifier is that the communications between the newsletters and their subscribers are *personal* and have developed into the kind of *fiduciary, person-to-person relationship* that is characteristic of a traditional advisor-client relationship.

First, Weiss Research provides advice attuned to the subscribers’ investment objectives by selecting the “best” premium services for them through a questionnaire. The emails subscribers receive contain trade orders to their broker-dealers. The newsletters are in fact *personal communications* in the guise of financial publications and a vehicle for individualized investment advice. Further, Weiss Research even obtains discretionary trading authority from auto-trading subscribers to execute trades pursuant to which Weiss Research can directly place trades with the subscribers’ broker-dealers. Weiss Research even works with broker-dealers to satisfy its recordkeeping duty as an investment advisor. Weiss Research also solicits subscribers with false and misleading advertisements. Therefore, Weiss Research’s publications are not bona fide or genuine because they primarily provide individualized investment advice. Weiss Research sends emails containing trading instructions through emails to premium service subscribers only when it sees an investment opportunity arise, and thus the publications are not of regular circulation in the sense of being important to the markets but are triggered by specific market events.

### Scenario III: *Terry's Tips*<sup>8</sup>

Terry's Tips markets options trading strategies and investment newsletters through its website and has begun to offer auto-trading to its subscribers. Typically, Terry's Tips emails an "Auto-Trade 101" message which recommends, but does not require, that the subscriber open a brokerage account at one of the broker-dealers that Terry's Tips has arrangements with. The email contains instructions on how to open an account, designate Terry's Tips as the advisor, and authorize the broker-dealer to take orders directly from Terry's Tips. Once the brokerage account is set up, Terry's Tips sends "trading alerts" –specific trading instructions—to the designated broker-dealer, then the broker-dealer executes those trades accordingly. After the trading alert are sent to the broker, Terry's Tips either posts it on its website or sends a copy to the subscriber. The trading alerts are not issued on a regular basis but are timed to specific market activity.

Auto-trading subscribers can also email questions to Terry's Tip. The staff personally respond to all emails and also provides specific advice on matters such as the degree of risk associated with each trading strategy, which strategy suits the subscriber's investment objectives, and when to switch from one strategy to another. Terry's Tips often uses false promises of unrealistic and unreasonable investment returns to deceive its subscribers.

#### Analysis

#### **Terry's Tips does not qualify for the Publisher Exclusion.**

Similar to the Weiss Research scenario, the most outstanding disqualifier is that the communications between the Terry's Tips and its subscribers are *personal* and have developed into the kind of *fiduciary, person-to-person relationship* that is characteristic of a traditional advisor-client relationship. First, Terry's Tips provides personalized investment advice to subscribers individually, by email, as to the degree of risk associated with each auto-trading strategy, which strategy best suits the subscriber's investment objectives, and when to switch to another strategy. The emails are in fact *personal communications* under the guise of financial publications and a vehicle for individualized investment advice. Further, Terry's Tips instructs subscribers how to open a brokerage account and to designate Terry's Tips as the *investment advisor*. As a result, Terry's Tips obtains discretionary trading authority from auto-trading subscribers to execute trades pursuant to which Terry's Tips can directly place trades with the subscribers' broker-dealers through the trading alerts. Terry's Tips also deceives its subscribers through false promises of unrealistic and unreasonable investment returns. Therefore, Terry's Tips' publications are not bona fide or genuine because they primarily provide individualized investment advice. Terry's Tips sends trading alerts only as a timed response to specific market activity instead of on a regular basis, so the publications are not of regular circulation.

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<sup>8</sup> *SEC v. Terry's Tips, Inc.*, 409 F. Supp. 2d 526 (2006).

## Scenario IV: *Tokyo Joe's Société Anonyme Corp*<sup>9</sup>

Tokyo Joe sets up a website consisting of two areas. One area has limited information accessible to the general public, and the other offers expanded information for paying members (*Société Anonyme* members) only. In addition to the hefty membership fee, *Société Anonyme* members can also pay a monthly fee for an exclusive interactive chat room where members can solicit more stock information from Tokyo Joe.

Tokyo Joe emails, posts, and discusses a number of stock picks, daily reactions to markets, and trading tips through the website. Typically, Tokyo Joe first composes and sends emails, posts alerts about stock tips on the members-only area, and then further discusses those posts in the exclusive chatroom; finally, Tokyo Joe makes some of his stock picks available to the general public.

Tokyo Joe has thousands of members on the website and sees an opportunity to make a fortune. For example, he encourages members to buy shares of certain stocks that he already owns, in order to inflate their prices, and then he subsequently sells his shares profitably. On other occasions, Tokyo Joe recommends members hold a stock for several days claiming that it will hit a target price, while Tokyo Joe immediately sells his stock or places limit orders below the "target price." Tokyo Joe sometimes promotes the stock of a certain issuer in exchange for compensation from that issuer. He never reveals his true interests in the stocks he recommends. To convince members to follow his advice, Tokyo Joe often posts effusive testimonials and false and misleading performance results on the website and the chatroom.

### Analysis

#### **Tokyo Joe/ *Société Anonyme Corp* does not qualify for the Publisher Exclusion.**

First, Tokyo Joe persuades members to purchase, sell, or hold specific stocks using effusive testimonials and misleading performance results, without disclosing that Tokyo Joe has an ownership interest in those stocks. Although Tokyo Joe's stock picks are not geared to particular individuals, he sends emails about those recommendations directly to individual email accounts and discusses them with individual members in the chatroom. The website appears to be a vehicle for investment advice. Therefore, Tokyo Joe's website does not contain disinterested or impersonal commentary and analysis. Second, Tokyo Joe promotes stocks for which he has been paid by issuers to recommend and disseminates promotional material generated by a tout. Therefore, Tokyo Joe's website is not a bone fide or genuine publication. Last, Tokyo Joe makes very limited information available to the public while he reserves extensive stock recommendations exclusively for fee-paying members and chatroom users. Therefore, Tokyo Joe's website is not a publication of general circulation.

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<sup>9</sup> *SEC v. Gun Soo Oh Park and Tokyo Joe's Société Anonyme Corp*, 99 F. Supp. 2d 889 (2000).

## Other examples

If the Publisher Exclusion criteria derived from *Lowe v. SEC* are met, the proprietor of a recorded telephone stock tip service and a person providing his or her own take on securities through email can qualify for this exclusion.<sup>10</sup>

### TAKEAWAY

Authors of the Advisers Act probably did not envision that one person could disseminate personalized investment advice to thousands of recipients across the country over the internet. The text of Section 202(a)(11) does not define “bona fide” or “general and regular circulation,” which makes it difficult for financial professionals to invoke the publisher exclusion but leaves plenty of room for regulators to enforce registration. Even if your practice appears to be identical to a fact pattern presented in a caselaw or a regulatory no-action letter, regulators may still find you in violation of the registration requirement and require you to register as an investment advisor. Financial professionals who wish to rely on the exclusion should make sure that their publications are genuine and do not inadvertently develop into an advisory relationship. The application of the publisher exclusion requires a careful factual and legal analysis of a proposed publication or website. Therefore, financial professionals are urged to consult with legal counsel before launching a publication, website, or service to determine whether they qualify for the publisher exclusion or need to register as an investment advisor due to certain features of the publication, website, or service.

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<sup>10</sup> See *Mary Lee Botsaris, SEC No-Action Letter*, 1993 WL 101686 (Mar. 25, 1993); *Russell H. Smith, SEC No-Action Letter*, 1996 WL 282564 (May 2, 1996).